No. 77-1776

In the Supreme Court of the United States

OCTOBER TERM, 1978

FRANK J. BEARDSLEE, ET UX., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the court of appeals (Pet. App. A-1 to A-9o) is reported at 562 F. 2d 1016. The opinion of the district court (Pet. App. A-13 to A-19) is not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A-10 to A-11) was entered on September 14, 1977. A petition for rehearing was denied on February 21, 1978 (Pet. App. A-12). The petition for a writ of certiorari was filed on May 22, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the obligations of a guarantor under a standard Small Business Administration loan guaranty agreement are discharged when a release is granted to the principal debtor.

STATEMENT

The facts in this case are set out in the decision of the court of appeals (Pet. App. A-3 to A-9). In 1964 and 1967 loans totalling $260,000 were made to the Beardslee Lumber Company. These loans were secured in part by a mortgage of real property and by security agreements covering machinery and equipment. In addition, petitioners signed Small Business Administration (SBA) Form 148 loan guaranty agreements, by which they undertook to pay any outstanding balance in the event of default by the principal debtor.[1]

On January 30, 1968, the lender assigned the notes and all related mortgages and security agreements (including petitioners' loan guaranty agreements) to the SBA. Soon thereafter Beardslee Lumber defaulted and filed a petition for arrangement under Chapter XI of the Bankruptcy Act, 52 Stat. 905, 11 U.S.C. 701 *et seq.*[2] The plan of arrangement proposed by Beardslee Lumber was approved by the bankruptcy court on June 3, 1968. Subsequently, Beardsley Lumber filed a proposal to amend the plan of arrangement to permit the collateral securing its debt to SBA to be sold to Freeport Hardwood for approximately

[1]Copies of the two agreements are shown at pages 3 and 4 in appellants' appendix (App.) in the court of appeals.

[2]The SBA filed evidence of its secured and priority claims with the bankruptcy court (App. 29-31).

$126,000.[3] As part of this proposal, the SBA agreed to release Beardslee Lumber from its security agreements so that it could convey clear title to the collateral to the purchaser.[4] The bankruptcy court approved this amendment to the plan of arrangement (Pet. App. A-6). In 1970, as part of an agreement under which Beardslee Lumber paid an additional $5,000, SBA released any further claims against Beardslee Lumber in the bankruptcy court.[5] This final amendment to the plan of arrangement was approved by order of the bankruptcy court dated June 22, 1970 (App. 38-43).

SBA then requested petitioners, as guarantors, to pay the outstanding balance of the loans. When petitioners refused to make payment, the United States instituted this action in the United States District Court for the Western District of Michigan. Petitioners argued that because of "the discharge of all claims against * * * Beardslee Lumber Company" approved by the orders of the bankruptcy court, "the guarantees executed by the [petitioners] * * * were also discharged" (App. 6).

The government argued in the district court that the release granted to Beardslee Lumber during the Chapter XI bankruptcy proceedings did not discharge the

[3]Freeport gave the SBA a secured note for the sale price. Freeport eventually defaulted on the note, and SBA compromised Freeport's debt for the sum of $90,000. In computing the upaid balance of the Beardslee Lumber Company debt to SBA, however, petitioners received full credit for the sale price of more than $126,000 (App. 50).

[4]Beardslee Lumber conveyed the property to Freeport by means of a quitclaim deed. SBA conveyed a release of its secured claims against Beardslee Lumber to Freeport (Pet. App. A-6).

[5]The $5,000 was the net proceeds received by Beardslee Lumber in settlement of the company's claim against a third party (Pet. App. A-7).

guarantors because 11 U.S.C. 34 provides that "[t]he liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt." The district court did not adopt the government's contention.[6] Instead, the court ruled that petitioners must repay the loans because the SBA Form 148 loan guaranty signed by petitioners in this case "waives the defense of a complete release of the principal debtor" (Pet. App. A-18b). On September 9, 1975, petitioners stipulated to the amount of the outstanding balance of the loans, and a judgment for $186,957.84 was entered in favor of the United States (Pet. App. A-23 to A-25).

The court of appeals affirmed. The court held that, under the principles of *Clearfield Trust Co.* v. *United States*, 318 U.S. 363, federal law should govern the interpretation of SBA Form 148 (Pet. App. A-9i). In determining the appropriate federal rule, the court looked to general commercial law. The court explained that "[n]umerous state court decisions * * * have held that the discharge of the principal obligor does not relieve the guarantor of liability where the right of recourse against the guarantor is expressly reserved * * * in the [guaranty] contract" (*id.* at 9j-9k). The court then reviewed SBA Form 148 and held that, under the "clear and unambiguous language contained in [the] Form, * * * the release of the principal debtor did not discharge the

[6]The court indicated that the bankruptcy court merely "ratified" the discharge of the debtor and that a ratification of this nature did not constitue a "discharge" within the protection of 11 U.S.C. 34 (Pet. App. A-16). The court's reasoning in this regard was erroneous for the reasons set forth in *R.I.D.C. Industrial Development Fund* v. *Snyder*, 539 F. 2d 487 (C.A. 5). (See p. 8, *infra*.)

obligation of the guarantors under this agreement" (*id.* at A-9*l*).[7]

ARGUMENT

1. The court of appeals properly determined that federal law rather than state law governs the interpretation of the release provisions of the SBA Form 148 loan guaranty agreement (Pet. App. A-9d to A-9i). The court of appeals' thorough analysis, on which we rely, reveals the significant federal interest in uniform construction of the release provisions of the SBA guaranty agreement and the absence of any countervailing domestic state interest that would require application of local law. Under the principles of *Clearfield Trust, supra,* it is therefore appropriate to apply federal law in construing the SBA form agreement.[8]

[7]The court found it unnecessary to consider the government's alternative contention that, under the express provisions of 11 U.S.C. 34, petitioners' liability as guarantors was not released by the discharge of the bankrupt.

[8]Petitioners' contention (Pet. 10-13) that the court of appeals' decision conflicts with other decisions does not withstand analysis. *United States* v. *Yazell*, 382 U.S. 341, involved a claim under an individually negotiated contract for a deficiency judgment that was contrary to the domestic coverture laws of Texas. The contract did not provide for the application of federal law or for a remedy that explicity overrode state provisions, and the court reserved any questions that would arise from such explicit provisions. *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, involved the issue whether oral agreements were effective to create or transfer an interest in leases under the Mineral Leasing Act. There was no federal interest that was infringed by the state rule. *United States* v. *MacKenzie*, 510 F. 2d 39 (C A. 9), and *United States* v. *Marshall*, 431 F. Supp. 888 (N.D. Ill.), involved the applicability of a right to redemption expressly provided by state law. As the Ninth Circuit later explained in *United States* v. *Gish*, 559 F. 2d 572, certiorari denied, April 24, 1978 (No. 77-1191), *MacKenzie* is a limited decision that does not require the application of state law to federal agreements when the federal agreements explicitly set out the role for the resolution of a particular dispute. See also *Small Business Administration* v. *McClellan*, 364 U.S. 446, 451-453.

We note, however, that petitioners' assertion that Michigan law should govern the construction of the guaranty agreement does not help them. Petitioners have cited no authority suggesting that Michigan law would release them from their obligations. Indeed, petitioners have cited no Michigan authorities at all. To the extent that applicable Michigan law can be determined, it is consistent with the general law relied on by the court of appeals in establishing the federal rule.[9]

2. Under general principles of guaranty law, the liability of the guarantor depends on the terms of the guaranty agreement. *United States* v. *Newton Livestock Auction Market, Inc.*, 336 F. 2d 673, 677 (C.A. 10); *United States* v. *Immordino*, 386 F. Supp. 611, 615 (D. Colo.), affirmed, 534 F. 2d 1378 (C.A. 10); *McCarthy Foundation* v. *Winshall*, 372 Mich. 389; see note 9, *supra*. SBA Form 148 provides that the obligations of the guarantor "shall not be released, discharged or in any way affected" by any action that the creditor "may take or omit to take" under its authority "to deal in any manner with the [l]iabilities and the collateral" (App. 3).[10] As the

[9]Michigan follows the general principle that "[c]ontracts of guaranty are to be construed like other contracts, and the intent of the parties as collected from the whole instrument and the subject matter to which it applies, is to govern." *First National Bank* v. *Redford Chevrolet Co.*, 270 Mich. 116, 121; see *Morris & Co.* v. *Lucker*, 158 Mich. 518. See also Pet. App. A-17.

[10]The creditor's powers include authority "to effect any release, compromise or settlement" with respect to the liabilities and "to realize on the collateral or any part thereof * * * or to forbear from realizing thereon * * * in its uncontrolled discretion" (App. 3).

court of appeals observed, every court that has construed the language of the SBA Form 148 agreement has concluded that the guarantor is unconditionally liable on default of the principal debtor and that the release of the principal debtor does not discharge the guarantor. See *United States* v. *Southern Cycle Accessories, Inc.*, 567 F. 2d 296 (C.A. 5); *United States* v. *Proctor*, 504 F. 2d 954 (C.A. 5); *Austad* v. *United States*, 386 F. 2d 147 (C.A. 9); *United States* v. *Newton Livestock Auction Market, Inc., supra; United States* v. *Immordino, supra; United States* v. *Dubrin*, 373 F. Supp. 1123 (W.D. Texas); *United States* v. *Krochmal*, 318 F. Supp. 148 (D. Md.); *United States* v. *Basil's Family Supermarket, Inc.*, 259 F. Supp. 139 (S.D.N.Y.); *United States* v. *Houff*, 202 F. Supp. 471 (W.D. Va.), affirmed, 312 F. 2d 6 (C.A. 4). The language of SBA Form 148 has been uniformly held to constitute "a consent by the guarantors that the release of the principal debtor did not discharge the guarantors." Pet. App. A-9*l*, quoting *United States* v. *Krochmal, supra*, 318 F. Supp. at 151. The court of appeals was thus correct in concluding that the

> reasonable interpretation of the clear and unambiguous language contained in Form 148, * * * [is] that as a matter of federal law the release of the principal debtor did not discharge the obligation of the guarantors under this agreement. [Pet. App. A-9*l*.]

Petitioners have not referred to any decision construing the language of SBA Form 148, or any similar language, in a different manner. There is thus no conflict among the circuits requiring resolution by this Court.

3. Petitioners contend (Pet. 24-27) that the action of the SBA in granting a discharge to Beardslee Lumber to permit a sale of the loan collateral to Freeport Hardwood, and the approval by the bankruptcy court of this

amendment to the plan of arrangement under Chapter XI of the Bankruptcy Act, discharged the guarantors. Petitioners assert (Pet. 26) that this result is compelled by the requirement that "full faith and credit [be] given to the orders of the Bankruptcy Court" (*ibid.*). Petitioners' contention, however, ignores the express language of 11 U.S.C. 34, which provides that the liability of a guarantor "shall not be altered by the discharge of such bankrupt." As the Fifth Circuit put it in *R.I.D.C. Industrial Development Fund* v. *Snyder*, 539 F. 2d 487, 491, "[o]ne of the primary purposes for obtaining a guarantor to a note is to provide an alternative source of repayment in the event that the principal obligor's debt is discharged in bankruptcy." Where a "debt owed the secured creditor is altered by a Chapter XI arrangement, the secured creditor's [right to proceed against the guarantor] is insulated by § 16 of the Bankruptcy Act [11 U.S.C. 34]." *Id.* at 492. See also *United States* v. *Anderson*, 366 F. 2d 569, 571 (C.A. 10); *United States* v. *George A. Fuller Co.*, 250 F. Supp. 649, 656-657 (D. Mont.); *United States* v. *Hass*, 152 F. Supp. 715, 716 (E.D. N.Y.); *Zellner* v. *Lasky*, 13 Cal. App. 3d 787, 91 Cal. Rptr. 810 (2d App. Dist.).

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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